Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200239035**
Release Date: 9/27/2002
Index Number: 671.02-00; 1042.00-00

Person to Contact:

Telephone Number:

Refer Reply To:
CC:TEGE:EB:QP2-PLR-156992-01
Date:
April 19, 2002

Taxpayers =

Company A =

State X =

State Y =

Dear :

This ruling is in response to the letter, dated August 15, 2001, on your behalf from your representative concerning the application of § 1042 of the Internal Revenue Code (the "Code") to certain transactions described below.

On , the Taxpayers sold stock of Company A to an employee stock ownership plan (ESOP), as defined in § 4975(e)(7) of the Code, maintained by Company A and elected nonrecognition treatment on the gain from the sale under § 1042 of the Code. You have represented that pursuant to the §1042 election, the proceeds of the sale were invested in qualified replacement property (within the meaning of §1042(c)(4) of the Code) within one year of the date of the sale.

You have represented that the Taxpayers contributed the qualified replacement property, along with other assets, to separate revocable trusts established under the laws of State X ("State X Trusts"). The trust instrument provides that the State X Trusts may be revoked by the grantor, in whole or in part, at any time before the death of the grantor. The grantor may also direct the trustee to pay amounts out of the trust estate to any other person or organization. Each Taxpayer is the sole grantor of his respective State X Trusts. [In addition, the trustee of the State X Trusts is not the grantor/neither Taxpayers are trustee of the State X Trusts]. You have represented that the Taxpayers are treated as the owners of their respective State X Trusts for federal tax purposes under § 671 of the Code.

The Taxpayers propose to transfer the assets of their respective State X Trusts to irrevocable trusts governed by the laws of State Y ("State Y Trusts") to eliminate State Y's Intangible Tax. [Neither Taxpayers are the trustee of the State Y trusts/The Trustee of the State Y Trusts is not the grantor, H or W.] The Taxpayers' State Y Trusts will be funded by the assets of their respective State X Trusts. This will occur prior to January 1 of each year. In addition, the State Y Trusts' governing trust documents require the trustee to transfer the entire trust estate to the State X Trust on April 30 of each year. Essentially, each year the assets of each State X Trust (including the qualified replacement property) will be transferred to the respective State Y Trust with a subsequent transfer back to the respective State X Trust. The State Y Trust instrument provides that during the grantor's lifetime, the Trustee may pay or apply all or any part of the net income or principal of the trust estate to the grantor, or for the grantor's benefit. Any undistributed income shall be added to the trust estate of the State Y Trust.

You have requested a ruling that the transfer of qualified replacement property from the State X Trusts to the respective State Y Trusts will not be treated as a disposition of the qualified replacement property within the meaning of § 1042(e) of the Code.

Code section 1042(e)(1) provides that "if a taxpayer disposes of any qualified replacement property, then, notwithstanding any other provision of this title, gain (if any) shall be recognized to the extent of the gain which was not recognized under subsection (a) by reason of the acquisition by such taxpayer of such qualified replacement property." Thus, gain realized from the disposition of any qualified replacement property by a taxpayer who made an election under section 1042 must be recognized at the time of the disposition regardless of any other nonrecognition provisions of the Code that may otherwise have applied.

Section 1042(e)(3) provides that the recapture rules of §1042(e)(1) shall not apply to any transfer of qualified replacement property that occurs: 1) in any reorganization (within the meaning of § 368) unless the person making the election under §1042(a)(1) owns stock representing control of the acquiring or acquired corporation and such property is substituted basis property in the hands of the transferee; 2) by reason of the death of the person making the election; 3) by gift; or 4) in any transaction to which §1042(a) applies.

Sections 671 through 677 of the Code contain rules under which the grantor of a trust will be treated as the owner of all or any portion of a trust. Section 677 of the Code provides that the grantor shall be treated as the owner of any portion of a trust whose income, without the approval or consent of any adverse party, is or may be distributed to the grantor or held or accumulated for future distribution to the grantor.

Based on the above, H & W will be treated as owner of their respective State Y Trust for federal tax purposes. Therefore, there is no disposition upon the transfer of the qualified replacement property from the State X Trusts to the State Y Trusts and vice versa.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,
ROBERT D. PATCHELL
Chief Qualified Plans Branch 2
Office of Division Counsel/
Associate Chief Counsel
(Tax Exempt and Government Entities)